Cargill

June 19, 2009

The Honorable Mike Crapo
United States Senator
239 Dirksen Senate Office Building
Washington D.C. 20510

Dear Senator Crapo,

I am writing in response to your request for input on the recent legislative proposals to alter the regulatory framework of over-the-counter derivatives. Cargill appreciates having this opportunity as we are an extensive end-user of over-the-counter derivatives in the interest rate, foreign exchange and commodity markets.

Cargill believes that improvements can and should be made to the OTC derivative markets and we support Congress and the regulators in their work with this initiative. From Cargill's perspective, it starts with:

- Increasing transparency and reporting of OTC transactions
- Putting in place enforceable position limits for non-commercial participants (i.e. speculators)

We are, however, concerned that the recent U.S. Treasury proposal seeks a "one-size-fits-all" regulatory solution for all OTC products in response to systemic risk posed by one particular market: credit default swaps. We believe that the regulatory reforms as they are presented today will have the unintended consequence of either increasing risk because companies like Cargill will choose to hedge less, or impeding business growth due to the diversion of working capital to margin accounts. These concerns will be further outlined below in our responses to your three questions:

- How does your company use customized over-the-counter derivatives to help stabilize prices and mitigate risk?

  Cargill uses customized over-the-counter derivatives to reduce earnings volatility and to give our customers (producers and end-users) more stable and predictable pricing. The advantages that customized over-the-counter products have over exchange products are the following:

  a) Ability to precisely tailor the product to meet the risk or exposure that needs to be hedged. For example, Cargill will often borrow at a variable rate. To hedge or manage the risk of rising interest rates, we will enter into an interest rate swap to lock in a fixed rate for the entire maturity of the debt. It is important to note that while interest rate derivatives currently are offered on US exchanges, these exchange-traded contracts are not customized to the specific terms of our debt issuances, creating an economic mismatch. In addition to the economic risks of the mismatch, if we are unable to execute a customized derivative, it will impact our accounting treatment. Customization allows us to qualify for hedge accounting under US accounting rules. Without hedge accounting, changes in the market value of the derivative will be recorded in our income statement, creating earnings volatility that is unrelated to our core business.

b) Customization has the benefit of giving a broader product mix and a more efficient and cost effective hedge than what is generically available on the exchange. For example, a product that gives protection against the average price of corn over a certain period may be a better hedge for a processer of corn that is buying corn every day. Average price products in corn are not available on the futures exchanges, but they are available in the over-the-counter markets. Averaging products are materially less expensive than traditional exchange products. Furthermore, the OTC markets allow for the averaging period to be set to the exact period that the hedger is looking to protect, insuring that the hedger does not overpay for his protection.

- What are the possible effects of severely restricting access to customized over-the-counter derivatives on your ability to manage risk and on the prices you charge your customers?

a) Recent proposals push for having OTC products either be exchange traded or centrally cleared. Our concern with this is that exchange traded products and centralized clearing require a high degree of standardization. Standardization will make it impossible for companies to achieve “hedge effectiveness” and comply with FAS 133 accounting standards.

b) Proposals apply rigid margining, including initial and variation margin, across all OTC markets (interest rates, currencies, commodities). While margining and other credit support mechanisms are in place and utilized every day in the OTC markets, there is flexibility in the credit terms, credit thresholds and types of collateral that can be applied. This flexibility is a significant benefit for end users of OTC derivatives such as Cargill in managing working capital. Losing this flexibility is particularly concerning because mandatory margining will divert working capital from investments that can grow our business and idle it in margin accounts. While it depends on market conditions, the diversion of working capital for Cargill for margining could be in excess of $ 1 billion. Multiply this across all companies in the U.S. and the ramifications are enormous, especially at a time when credit is critically tight.

- What safeguards are in place to ensure that your derivatives portfolio is a tool for hedging risk, rather than a source of risk for your company?

Cargill has the following safeguards in place:

a) Policies for the use of over-the-counter derivatives.

b) Independent risk group and risk analysts in the company that monitor use of derivatives.

c) Centralized Financial and Commodity Risk Committees that set policy, limits, and review exposures.
d) Separation between accounting and commercial managers to independently verify valuations of positions.
e) Significant credit resources to analyze and monitor counterparty credit exposure.
f) Daily valuation of derivative positions.
g) Stress testing of positions.
h) Use of bi-lateral credit agreements with margining provisions with OTC counter-parties.
i) Resources and systems for valuing positions and moving collateral daily with OTC counterparties to manage credit exposures.

With regard to (h) and (i) above, we believe that there is a misconception that transactions in the OTC markets do not have credit provisions and are not margined or collateralized. A significant number of OTC transactions are margined with collateral being moved daily. With exchange products or centralized clearing, margining terms are standardized, since counterparties do not know each other and there is no counterparty risk analysis performed. In the OTC market credit and collateral terms vary and are set according to the credit quality of the hedger and the size and duration of the OTC transaction. As stated above, this flexibility in setting credit terms is critically important in managing working capital.

Again, I want to thank you for the opportunity to answer your questions and express our concerns. We appreciate your interest in this matter and we look forward to working with you in the days ahead.

Sincerely,

David Dines

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